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IN THE
# Supreme Court of the United States
OCTOBER TERM, 1997

UNUM CORPORATION and
UNUM LIFE INSURANCE COMPANY OF AMERICA,
*Petitioners,*

v.

UNITED STATES OF AMERICA,
*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit**

## REPLY BRIEF FOR PETITIONER

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## REPLY BRIEF FOR PETITIONER

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1. The government acknowledges (Opp. 16) that the question presented has "enormous tax consequences," and it does. As we explained in the petition (pp. 11-13), and as the Court of Appeals recognized below, whether distributions made to policyholders as part of a demutualization are deductible "policyholder dividends" within the meaning of Subchapter L of the Code has "great financial consequences" for the insurance industry as well as the "public fisc." Pet. App. 2a. This past February the Nation's largest mutual insurer, Prudential, announced its intention to demutualize, *see* Pet. 5 n.2; since the petition was filed, yet another major mutual insurer, John Hancock, announced it was following suit, leading one observer to remark that the mutual insurance industry, while typically "excruciatingly dull," has become "interesting"—

"[e]xciting, even." Allan Sloan, *Deals*, Wash. Post, June 2, 1998, at C3.

The question whether such policyholder distributions are deductible not only is undeniably important and certain to recur, but is cleanly presented by this case, in which the First Circuit decision squarely answering that question in the negative has resulted in the imposition of at least a $77 million tax burden on UNUM. *See* Pet. 11 & n.6. As we explained in the petition (p. 12), this Court has granted certiorari in numerous cases presenting tax issues of such magnitude, even in the absence of an entrenched circuit conflict. In response, the government says these cases are "not on point" because they involved review of decisions that "were adverse to the government." Opp. 17. But this Court has never suggested that its certiorari docket operates in such a one-way fashion. Where, as here, an important federal tax ruling is plainly —or even arguably—contrary to Congress' intent, certiorari is just as appropriate when the ruling imposes an unintended burden on the taxpayer, as when it adversely affects the tax collector.[1]

Given the hundreds of millions of dollars of potential tax liability implicated by the question presented as the Nation's major mutual insurers race towards demutualiza-

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[1] The government's suggestion that acceptance of UNUM's position would result in a "tax bonanza" (Opp. 16) for mutual insurers reflects a fundamental misunderstanding of the tax rules governing the flow of capital through mutual insurers as opposed to stock companies. Mutual insurers—unlike stock companies—must include in their taxable income capital contributions or their equivalent (including redundant premiums) when received. *See* Pet. 5-6. As a result, far from granting mutual insurers a "tax bonanza," recognizing that such capital is deductible when it is distributed back to policyholders as part of a demutualization would simply insure that mutual insurers are not saddled with an enormous tax *burden* not imposed upon stock companies—*i.e.*, being taxed on both the receipt *and* return of capital (or its equivalent)—and, instead, are accorded tax treatment equal to that of stock companies. *See* Pet. 27.

tion, as well as the need for certainty on federal tax issues of such enormity, there is ample reason to grant certiorari on the basis of the undeniable importance of this "landmark case" alone. S. Preston Ricardo, *The Deductibility of Policyholder Dividends:* UNUM Corp. *v.* United States, 50 Tax Law. 265 (1996) (quotation omitted); *see* Pet. 11-13. But as we explained in the petition (pp. 13-19), the question presented is not only undeniably important, it is the subject of conflict and confusion, too.

2a. That confusion is highlighted by the conflicting positions that the Internal Revenue Service itself has taken on the question presented. The government astonishingly asserts (Opp. 14) that "the Service has consistently treated [policyholder distributions made during a demutualization] as a tax-free exchange that creates neither income for the shareholders nor a deduction for the insurer," but the Court of Appeals below was in fact on the mark when it stated that "[t]he IRS has not always held th[e] view [it now expouses] regarding the tax treatment of distributions from surplus made during a demutualization," and—while the government inexplicably neglects to acknowledge as much—that "the IRS [previously] took the view now advanced by UNUM that cash *distributions paid out of surplus to policyholders during the demutualization were policyholder dividends* * * *." Pet. App. 12a n.6 (emphasis added). The IRS's own flip-flop on the important question presented says a great deal about the confusion that surrounds this issue, as well as the serious arguments on both sides of it.[2]

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[2] In an effort to redirect the Court's attention from the IRS's own about-face on the question presented, the government claims (Opp. 14) that UNUM has "taken conflicting positions in this case." It is true that, as we pointed out in the petition (p. 8), UNUM initially did not claim a deduction for the policyholder distributions at issue. But it is undisputed that UNUM properly amended its tax return—based on its further consideration of the federal tax question presented—to claim such a deduction. UNUM's indecision on this important issue was in part a product of the uncertainty currently surrounding the availability of the policy-

b. The government also refuses to acknowledge the basic conflict between the First Circuit's "strict[]" (Pet. App. 47a) construction of the statutory definition of the term "policyholder dividend" and the "expansive," plain meaning construction of that same term by the Fifth Circuit in *Republic National Life Insurance Co.* v. *United States*, 594 F.2d 530, 532 (5th Cir. 1979), and by the Treasury Department in Treas. Reg. § 1.811-2(a) (1961) ("In general, *any* payment not fixed in the contract * * * shall be treated as a dividend to policyholders.") (emphasis added). *See* Pet. 13-16. According to the government, the fact that other federal circuits and the Treasury Department have—quite unlike the First Circuit below—taken at face value the broad definition of the term "policyholder dividend" is of no moment, because the cases cited do not specifically apply the term to distributions "made in the context of a demutualization." Opp. 13; *see id.* 13 n.10, 15 n.12. But as we explained in the petition (pp. 20-21), any objective, plain meaning construction of the open-ended language Congress used in Section 808 to define "policyholder dividend" should result in the conclusion that the distributions at issue are deductible. The government's narrow emphasis on "context" is no answer to the outcome-determinative effect that a strict versus plain meaning construction of the term "policyholder dividend" has on the resolution of the important question presented by this case.

"Policyholder dividend" is defined to include "*any* dividend or similar distribution," and "*any* amount * * * not fixed in the contract." 26 U.S.C. § 808(a), (b) (emphases added). Congress in 1984 specifically added the word "any" to the general definition in Section 808(a) to underscore the term's breadth. *See* Pet. 27. That should eliminate any doubt as to the term's intended reach, for, as this Court has recently emphasized, Congress' use of

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holder dividends deduction in the demutualization context, and thus, to the extent it is relevant here, simply underscores the need for this Court's review.

the word "any" "undercuts the attempt to impose [a] narrowing construction," *Salinas* v. *United States*, 118 S. Ct. 469, 473 (1997), and should be taken at "face value," even if it gives a term "remarkable breadth." *Bennett* v. *Spear*, 117 S. Ct. 1154, 1162 (1997). The government's basic response seems to be that Congress could not possibly have meant what it said because the type of distributions at issue in this case do not fit the mold of the typical *corporate* dividend. *See* Opp. 10-11. But as the Fifth Circuit specifically recognized in *Republic National*, Subchapter L's "expansive" definition of the term "policyholder dividend" was "intended to include *more* than just classic dividends." 594 F.2d at 532 (emphasis added). This makes perfect sense because, as we explained in the petition (pp. 5-6), the flow of capital through stock companies is taxed under an entirely different scheme than the one established in Subchapter L for insurers. *See* note 1, *supra*.

While it is unnecessary—at least under a plain-meaning construction such as the Fifth Circuit's in *Republic National*—to go beyond the text of the statutory definition of the term "policyholder dividend" to reach this conclusion, there is ample indicia of congressional intent to support it. *See* Pet. 25-26. Thus, for example, the principal drafter of the statutory definition of "policyholder dividend" stated that "the word 'dividend' in life insurance companies has a *different* connotation than we would use in the investment field." 105 Cong. Rec. 2571 (1959) (statement of Sen. Curtis; emphasis added). *See Republic National*, 594 F.2d at 536 (congressional "debates reflect an understanding that 'dividend' as used in the insurance industry is a *term of art* which means almost *any* payment not derived solely from premium income") (quotation omitted; emphases added); Pet. 25 (dictionary definition). To cement the point, Congress specifically declared in Subchapter C that the definition of "dividend" for general corporate matters "shall *not* apply to the term 'dividend' as used in subchapter L in any case where the

reference is to dividends of insurance companies paid to policyholders as such." 26 U.S.C. § 316(b) (emphasis added).[3] The government—like the First Circuit—simply refuses to take Congress at its word.

The context in which the Fifth Circuit adopted its plain-meaning construction of the term "policyholder dividend" in *Republic National* is different in one important respect from that in which the First Circuit adopted its strict construction below: the Fifth Circuit did so at the urging of the *government* which—consistent with Treas. Reg. § 1.811-2(a) (1961)—argued that the term "policyholder dividend" should be "expansive[ly]" construed. 594 F.2d at 532. As we explained in the petition (pp. 15-16), under the tax scheme in effect at the time *Republic National* was decided (1979) that position was generally favorable to the government, since policyholder dividends were deductible only in part. Congress changed this scheme in 1984, making policyholder dividends deductible almost in their entirety. And yet, while Congress at the same time *expanded* the definition of the term "policyholder dividend," *see* Pet. 16, the government after the 1984 amendments took the opposite view that the term "policyholder dividend" should be construed narrowly. The government may have valid institutional reasons for flipping positions on the meaning of the term "policyholder dividend" in light of the suddenly unfavorable tax consequences of its previous, plain-meaning interpretation of that same term, but it may not maintain with a straight

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[3] Each of the cases cited by the government for the proposition that the distributions at issue in this case are not "policyholder dividends" within the meaning of Subchapter L involve application of the statutory definition of the classic *corporate* dividend for purposes of Subchapter *C*. *See* Opp. 10-11 (citing *Hellmich* v. *Hellman*, 276 U.S. 233, 237 (1928); *United States* v. *Davis*, 397 U.S. 301, 313 (1970); *Citizens Bank & Trust Co.* v. *United States*, 580 F.2d 442, 446 (Ct. Cl. 1978); *Commissioner* v. *Pope*, 239 F.2d 881 (1st Cir. 1957)).

face that its position on the meaning of the term has been "consistent[]." Opp. 14.

c. The government relegates to a footnote (Opp. 12 n.9) its effort to reconcile the First Circuit decision below with the settled norms of statutory construction adopted by this Court. Even then, it chooses not to respond to the specific conflicts identified in the petition (pp. 19-28), but instead simply states in blanket fashion that the First Circuit decision accords with the principles that a "statute [should be viewed] as a whole and [by] placing the provisions [at issue] in their proper context." Opp. 12 n.9. We agree that the statute should be read against this backdrop, which is why the different schemes established by Subchapters C and L for taxing the flow of capital through stock as opposed to insurance companies—which the government refuses to acknowledge—are key to answering the question presented. But the government fails to come to grips with the "one, cardinal canon before all others"—"that courts must presume that a legislature says in a statute what it means and means in a statute what it says there." *Connecticut Nat'l Bank* v. *Germain*, 503 U.S. 249, 253-254 (1992); *see* Pet. 19-21. That canon is especially important in construing the federal tax code, where the need for certainty and predictability—especially among businesses that must continuously evaluate the fiscal implications of their actions—is so great.

3. On the merits, the government astonishingly asserts that UNUM's claim is "refuted" by Section 808(a), a provision which it says we "essentially ignore." Opp. 11. As the petition (pp. 13, 16, 27, 28) alone should make clear, however, we do not ignore Section 808(a). We embrace it. That provision states in open-ended fashion that "the term 'policyholder dividend' means *any* dividend or similar distribution to policyholders in their capacity as such." 26 U.S.C. § 808(a) (emphasis added). Congress, as noted, added the word "any" to Section 808(a) when it amended the statute in 1984, putting an exclama-

tion point on the term's breadth. *See* Pet. 27; *supra* at 4. The fact that the distributions at issue in this case *also* plainly meet the more specific definition found in Section 808(b), *see* Pet. 13, should resolve any doubt as to whether they fit within the general definition in Section 808(a).

In construing Section 808(a), the government's basic hang up seems to be the word "dividend." Here, the government commits the same basic error as the Court of Appeals: it assumes that Section 808's definition of "policyholder dividend" does not reach distributions made as part of a demutualization because, the government says, such distributions are unlike ordinary *corporate* dividends. *See* Opp. 10-11, 14-15. In other words, when it comes to construing the word "dividend," the government takes the term out of the insurance context in which it resides (*i.e.*, Subchapter L) and ascribes to it the meaning it has in the general corporate context (*i.e.*, Subchapter C). *See* Opp. 10-11 (relying solely on general corporate cases to define "dividend"). As explained, however, the government's analogy to general corporate tax principles is inapt in light of the fundamental differences in the manner in which the tax code treats the flow of capital through stock versus insurance companies. Indeed, if the analogy were apt, then mutual insurers would not be required to include redundant premiums in their taxable income in the first place (since corporations are not required to include the equivalent capital contributions in their taxable income, *see* Pet. 5-6), and policyholder dividends would not be deductible at all—even though Subchapter L plainly says they are.

The government also defends the First Circuit's misplaced reliance on *Colonial American Life Insurance Co.* v. *Commissioner*, 491 U.S. 244 (1989). *See* Opp. 15-16. As we explained in the petition (pp. 21-22), *Colonial American* does not even mention Subchapter C (or any

of its provisions), let alone purport to "address[] the relationship between Subchapter C and Subchapter L," Pet. App. 16a, as the Court of Appeals and now the government claim. More important, the whole premise for the First Circuit's and government's reliance on *Colonial American*—"that there [is] no specific provision in Subchapter L that provide[s] for the claimed deduction," Opp. 16—is mistaken. Subchapter L not only speaks to the matter in Sections 805 and 808 but—taking Congress' word at face value—specifically allows insurers to deduct distributions made to policyholders as part of a demutualization. 26 U.S.C. §§ 805(a)(3), 808, 809(f)(4); Pet. 13. Accordingly, even assuming *Colonial American* may be elevated into the "rule" (Pet. App. 16a) formulated for the first time by the Court of Appeals below, it is of no avail to the government in seeking to deny UNUM the deduction to which it is specifically entitled under Subchapter L.[4]

* * * *

For the foregoing reasons, and those in the petition, the petition for a writ of certiorari should be granted.

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[4] The government's reliance (Opp. 8) on Section 162(k) is also misplaced. That provision was enacted in the context of Congress' concern that *stock* corporations—which, unlike mutual insurers, are not taxed on the receipt of capital, and so do not enjoy a deduction for its return to investors—were trying to find ways to deduct payments made in re-purchasing stock from stockholders. *See* S. Rep. No. 99-313, at 223 (1986) ("The committee understands that some corporate taxpayers are taking the position that expenditures incurred to repurchase stock from stockholders to prevent a hostile takeover of the corporation by such shareholders—so-called 'greenmail' payments—are deductible business expenses.") It has no application to the policyholder distributions at issue in this case, which are subject to the special rules set forth in Subchapter L.

Respectfully submitted,

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